

STATEMENT OF
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BEFORE THE
HOUSE ARMED SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES
ON
DEFENSE INDUSTRY SELF-GOVERNANCE
WEDNESDAY, AUGUST 10, 1988

Mr. Chairman and Members of this Committee on behalf of the Ethics Resource Center I thank you for this opportunity to provide testimony to this body concerning aspects of the current defense industry scandal and the industry's efforts at self-governance.

I serve the Ethics Resource Center as Executive Director a position I have held for more than seven years. Prior to becoming its Executive Director, I served for two- and one-half years as the Center's Program Director, with responsibilities for the design and conduct of research on the self-governance policies and programs of corporations and unions, as well as trade and professional associations. The Center has conducted four such studies, including one conducted on behalf of the President' Blue Ribbon Commission on Defense Management in December 1985. My testimony today is

based upon those studies, as well as the Center's experience as an advisor to dozens of US and multi-national corporations and associations seeking to establish standards of ethical conduct and to design and conduct educational programs that effectively communicate organizational values and personal responsibilities.

About the Ethics Resource Center

The Ethics Resource Center is a non-profit, non-partisan and non-sectarian educational organization founded in 1977 with the mission to strengthen public trust and confidence in the institutions of our free society. We serve the public not as a public policy or lobbying organization but, as our name suggests, as a resource center for information, advice and educational products and service that are intended to strengthen public trust and confidence in business, government, profession and education institutions by raising their level of ethical conduct.

When the Ethics Resource Center was founded, its Board of Directors felt strongly that the Center should not depend upon federal government grants or contracts for its support but should look to foundations, companies and a concerned public for support. As a result, the early years of the Center's development were focused on understanding ethical problems in the private sector in order that we might provide practical assistance in that area and merit its support.

Thanks to that public support, the Ethics Resource Center has been able to Assist not only companies, but also local governments, including Chicago and Milwaukee and smaller municipalities; federal agencies, including the Internal Revenue Service and the United States Postal Service; national youth organizations such as the Boy Scouts of America and Junior Achievement; as well as numerous local service organizations including Rotary Clubs and Better Business Bureaus. The Ethics Resource Center's educational materials on business ethics, including test books and video dramatizations of ethical issues, are in use in dozens of graduate business schools, as well as undergraduate colleges in this country and abroad. Once Center publication, Common Sense and Everyday Ethics, a copy of which is appended to my testimony, has been widely distributed and printed not only for the general public, but within the armed services as well, where reprint rights were granted to the

Army infantry Training Center at Fort Benning and to U.S. Naval Academy
For inclusion in its textbook on leadership. Current Ethics Resource Center
Efforts include the planned production of curricular materials to assist in
Character and citizenship education in public and private elementary schools,
as well as materials on work-related values education in high schools.

Four Questions About Industry Self-Governance

My testimony today concerns what the Ethics Resource Center has learned in
Its work with defense contractors, its research for the Packard Commission,
And its service as the External Independent Organization for the thirty-four
Companies, signators to the Defense Industry Initiative, who participated in 1987 in the public
accountability process called for by the sixth principle of
The public has been provided to this Committee by Mr. Yuspeh. The Center's
Earlier report and recommendations to the Packard Commission is appended to my
testimony

I would like briefly to address four questions:

1. What is meant by "self-governance"?
2. What has been the Ethics Resource Center's role in the defense
Industry's self-governance efforts?

3. To what extent does the present scandal involving the improper Gathering of competitors' intelligence, directly by companies or Self-governance?
4. What more can be done to strengthen ethical conduct in defense Procurement and management?

What Is Meant by "Self-Governance"?

The concept of self-governance recognizes that organizations have a responsibility to govern their own affairs in a manner which merits the public trust and confidence place in them.

Self-governance implies an obligation to provide employees with clear standards of proper conduct and an internal environment that is supportive of proper conduct. Self-governance is not a privilege that companies should seek from government, nor is it a right that they can assert. It is a responsibility and an obligation for which the management and directors of a company should be held accountable.

Self-governance is not an alternative to governmental regulation. It does not liberate companies from the requirements of the law or from regulatory oversight, nor does it excuse government from the conscientious performance of its own responsibilities for oversight and enforcement. Ideally,

self-governance set and achieves ethical standards that are higher than the requirements of the law and, in so doing simultaneously draws upon and nourishes a moral force in its employees that is altogether different from the spirit of grudging compliance with -- or that of adversarial evasion of-- externally imposed legal requirements. When self-governance is effective, the public's trust is merited and secured. When self-governance fails, a measure of economic freedom is lost as government moves to protect the public's interest and re-establish its trust.

Because of the peculiar nature of government contracting and the overriding public interest in a strong defense capability, the scope of industry self-governance has been narrowly conceived and the reliance on governmental supervision and intervention has been correspondingly expanded. As the regulatory role has grown, self-governance has atrophied and the moral force of principle and conscience has been overpowered by an adversarialism and gamesmanship that cares nothing for the spirit of the law and attends the letter only to search out the loopholes that defeat it.

As the Packard Commission recognized, if we are to have responsible contracting and a strong defense, the attitudes both of the contractors and of regulators must change in fundamental ways. Adversarialism must yield to trust and to collaboration for the public good. The recommendations on self-governance by the Commission and the response represented by the Defense Industry Initiative represent important, if flawed, efforts to achieve such changes.

What has been the Ethics Resource Center's Role in the Defense Industry's Self-Governance Efforts?

The Packard Commission asked the Ethics Resource Center to provide recommendations to the Commission about industry self-governance activities that might be considered for inclusion in their report to the President. The Center's recommendations, which are appended to my testimony, were incorporated by the Commission in its report.

Those recommendations also informed the industry's response to the Packard Commission's report, although the six principles of the Defense Industry Initiative go beyond our recommendations in two important respects: voluntary Disclosure and public accountability.

Because of our familiarity with the industry and our understanding of self-governance we were asked by the signators to the DII to serve as the external independent organization to report on the audits of the companies ethics programs. The Center was not asked to perform those program audits and evaluate the programs' efficacy. That was the responsibility of each company's independent accounting firm or law firm whose efforts were guided to meet, the requirements of the DII principles. The Center's report was based upon those audits and our interviews with the firms which conducted them. The Center Also provided comments to the Defense Industry Initiative Working Group concerning ambiguities in some of the audit questions and Provided recommendations for improving the public accountability process.

To What Extent Does the Present Scandal Take
the Measure of Industry Self-Governance?

We have been asked frequently in recent weeks whether the present scandal proves that self-governance does not work. We believe it is too early to draw that conclusion. Many of the contractor programs are less than two years old and had not been implemented when the misconduct being alleged in the press would have occurred. Moreover, programs that involve serious educational efforts will necessarily take many months to execute fully. Hotlines and ombudsmen programs will require considerable time for their informal validation by employees before they are fully trusted and utilized.

The current industry investigations do, however, underscore the need for industry to attend more carefully to the scope and content of its standards of conduct and its ethics training. Most corporate ethics policies and training programs with which the Center is familiar deal inadequately, or not at all, with company standards for consultants or for marketing personnel when gathering competitors' intelligence. Indeed, in its report to the Packard Commission, the Ethics Resource center observe that:

“Marketing is an area where misconduct may arise because of the absence of clear standards of conduct. Management that rewards marketing personnel for gathering competitors' intelligence, but provides no guidelines for acceptable conduct for obtaining the information may, in effect, encourage unethical or illegal behavior. Not only may performance incentives thus encourage employees to behave illegally or unethically, but consultants may be similarly influenced indirectly by employees who feel neither obliged nor encourage to inquire into their activities.”

And:

“Based on the survey results, documents analysis, and interviews and discussions with executives, managers, and employees of several defense firms, we have found that clear standards of ethical business conduct are especially needed with respect to contract negotiating practices and bidding practices, including the related activities involved in gathering competitors' intelligence

And again:

“Because some of these issues concern competitive practices, a company may be unwilling to take corrective action without assurances that others in the industry will as well. An example of such an issue is the gathering of competitors’ intelligence. Very few firms in the defense industry (or other industries, for that matter) have promulgated standards of conduct to guide marketing and other personnel in this area. Because of the absence of clear standards and because of the rewards and incentive to obtain competitors’ intelligence, many firms may be at risk that employees will engage in unethical or even illegal practices. Should such practices of defense contractors come to public attention, the confidence and trust of the public and of the government would be further eroded.”

Although the self-governance initiatives being undertaken by many defense Contractors do seem to the center to be both serious and substantive, they Represent first efforts which must be improved upon inf they are to provide Adequate guidance and support to employees.

What More Can Be Done to Strengthen Ethical Conduct
In Defense Procurement and Management?

The Ethics Resources Center respectfully proposes the following
Recommendations to industry and to the government:

To corporate executives in the defense industry, we recommend:

First, review and adoption of the Center's eight recommendations contained
In its report to the Packard Commission;

Second, internal review for adequacy of scope and content of each
Company's own code of ethics and ethics training program;

Third, establishment of ethics committees of outside directors to monitor
Corporate self-governance programs;

Fourth, an ongoing, active process through which industry can identify
Emerging ethical issues and develop modern standards and guidelines. The use
Of consultants and the gathering of competitors' intelligence were once such
Issues. Current areas of concern include information-sharing and
Whistleblowing in teaming situations, and the downstream risks of unethical
Conduct as a result of "buying into" contracts.

To the Reagan Administration, we recommend reconsideration of the policy
Of "cost-sharing." It appears to this observer that cynical advantage has
Been taken of the public's justifiable outrage over past contractor
overcharging and mismanagement. The Administration has, in effect, said to
Industry: "We want what we want and we don't care that we can't afford it
Take it out of your past inflated profits." If contractor profits have been
Inflated, they should be disgorged. If the Administration believes that

increase defense expenditures are called for, then let it seek a public mandate for them. "Cost-sharing" puts contractors in the position of having to buy into programs. Buying-in shifts the ethical risks from procurement to contract performance where pressures for unethical conduct are dramatically increase.

In the past, companies often chose to buy into contracts, bidding less than they believe it would cost, in order to secure a competitive advantage and win the contract. But in the past, contractors counted on "getting well" with contract changes and follow-on production work. In today's environment contract change requests are going to receive close scrutiny and, if granted, are not likely to garner any hidden profits. And follow-on work will be competed. With no way to get well with increased revenues, project managers will soon be looking for creative ways to cut costs. Past creativity has given us product substitution, mischarging and poor quality. To the Reagan Administration

Will the future be different? If so, it will be in spite of the Administration's cynical and deceptive "cost-sharing" policy. And it will be in spite of the gutless knuckling-under of industry executives who agree to promise the government the impossible for fear that, if they do not, their competitors might. It is one thing for a CEO to say today, "Okay, we'll eat the profits on this program, so we can be players down the road who are running out of money on their piece of the contract and are under management pressure to cut costs.

To this committee and to the other members of Congress, we recommend three specific actions that would strengthen the public's confidence in the integrity of defense procurement:

First, prior to the appointment of a new Congressional Salary Commission, pledge yourselves publicly in advance to abide by its recommendation for your salaries and forswear any outside income other than from prior investments maintained in blind trust. Honoraria for speeches and site visits undermine respect for your integrity and independence. Have the courage to demand to be paid what you're worth, instead of degrading yourselves and your high office by trying to sneak in the difference.

Second, do away with double standards on ethics between the executive and legislative branches and demand of yourselves and of your staff member the same high standards of ethics that you properly demand of executive branch personnel.

Third, exercise the moral courage and leadership that led you to choose a life of a public service in the first place and refuse to indulge in pork-barrel politics with the defense budget. When you force the Armed Service to buy weapons, equipment or services they do not need or want in order to direct contracts and jobs to your own district, you do not serve your constituents interests – you abandon their interests and that of the nation to serve your own personal interest in re-election. Public office is a public trust, not a private right. Prove yourselves as worthy of it now. As when you first aspire to it.'